Pennsylvania: Philadelphia attempts to exclude tax inversion companies from city contracts

David M. Kall | Friday, April 15, 2016

Philadelphia City Council president **Darrell L. Clarke** has introduced an **ordinance** that would bar the city of Philadelphia from "entering into contracts with companies that hide overseas to avoid paying U.S. taxes." More specifically, as a prerequisite to the execution of any city contract, each bid must contain a clause stating that the "Business Entity is not a tax inversion company." Any contract, lease, grant condition or other agreement entered into by the city, or by any city-related agency, for the procurement of goods and services must contain the clause.

The ordinance defines a tax inversion company as "[a]ny corporation that was legally domiciled in the United States of America that relocated its legal domicile on or after July 1, 2016, to a lower-tax nation, or corporate haven, and that currently retains its material operations in the United States of America."

A tax inversion company also includes any company that employs an earnings-stripping strategy, under which "the company uses loans between different divisions, or subsidiaries, of the same company to shift profits out of the United States of America's jurisdiction and into lower-tax foreign jurisdictions."

Waivers are available under certain circumstances, such as when there is no other source for the goods and services; the goods and services are necessary and essential to the protection of the public health and safety, and cannot be procured from any other source; and when the prohibition increases the cost of the procurement by more than 10 percent relative to the next lowest bidder. However, Clarke believes that "[t]hese tax avoidance schemes are unpatriotic, and are another example of how wealthy corporate interests manipulate the tax system to benefit themselves at the expense of their own nation…Companies that exploit this loophole should not further benefit through public works projects funded by taxpayers."

Inversions are on many lawmakers' minds, in light of the recent announcement that biopharmaceutical giants Pfizer, based in New Jersey, and Allergan, headquartered in Dublin, called off their merger last week. A Pfizer **press release** blamed the decision on "adverse tax law changes" that the U.S. Department of Treasury (USDOT) announced just two days prior to the termination.

The USDOT defines a corporate inversion like the Philadelphia ordinance does, but is more specific:

> "[A] U.S.-parented group engages in an inversion when it acquires a smaller foreign company and then locates the tax residence of the merged group outside the United States, typically in a low-tax country. Typically, the primary purpose of an inversion is not to grow the underlying business, maximize synergies, or pursue other commercial benefits. Rather, the primary purpose of the transaction is to reduce taxes, often substantially."

Philadelphia is one of the few jurisdictions so far that has linked corporate inversions to a ban on government contracts, but not the only one. New Jersey's **Assembly Bill 3624** passed the Assembly in December 2015. Lawmakers reintroduced it this legislative session as **Senate Bill 628** and **Senate Bill 1513**, but it has gone no further.

There is controversy as to whether state measures like those described here make any difference, termination of the Pfizer/Allergan merger notwithstanding. Last December, the New Jersey Business & Industry Association (NJBIA) **urged** the state assembly to reject its inversion bills. Andrew Musick, NJBIA's director of taxation and economic development, reasoned that inverters are trying to manipulate federal tax consequences, which have nothing to do with state programs or state contracts. "In fact, they have little to no impact on New Jersey's Corporate Business Tax collections or the jobs and facilities located in the state" but "may wind up costing New Jersey well-paying jobs and could also make it harder to attract companies to the state by reinforcing New Jersey's reputation as anti-business."

More important, some say, is the fact that the United States has not just an uncompetitive tax code, but the highest corporate income tax rate in the industrialized world, topping out at 34 percent, according to the Tax Foundation's **International Tax Competitiveness Index 2015**. It should be noted that this is a statutory rate, and not necessarily what corporations actually end up paying.

Even so, the general feeling that United States corporations have a moral obligation to pay their fair share persists.

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